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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 127

EVELYN F. GREGORY, *Petitioner,*

v.

GUY T. HELVERING, Commissioner of Internal Revenue

On a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

---

BRIEF AMICUS CURIAE

ELLSWORTH C. ALVORD,
EDWARD H. MCDERMOTT,
Amici Curiae.

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BRIEF AMICUS CURIAE

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 8-11) is *reported in* 27 B. T. A. 223 and of the Circuit Court of Appeals (R. 52-56) in 69 F. (2d) 809.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Second Circuit was entered March 26, 1934. (R. 38) Petition for certiorari was filed June 23, 1934, and was granted October 8, 1934. (R. 39) The jurisdiction of this

Court is invoked under section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (c. 229, §1, 43 Stat. 938), and section 1003 of the Revenue Act of 1926.

QUESTION PRESENTED

The exact question presented depends on the interpretation of the Circuit Court of Appeals' opinion and may be stated as follows:

(1) Is the term "reorganization", as defined in section 112(i)(1) of the Revenue Act of 1928, applicable to a transaction falling directly within the ordinary meaning of such definition but, in the opinion of the court below, not germane to ordinary business activities?

(2) Does a purpose to reduce income tax prevent a transaction which is otherwise within the words of the statute from being a "reorganization" as that term is defined in section 112(i)(1) of the Revenue Act of 1928?

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1928, c. 852, 45 Stat. 791, 818, provides:

"**SEC. 112. RECOGNITION OF GAIN OR LOSS.**

* * * * * * *

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

"(1) *The term 'reorganization' means* (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or *(B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,* or (C)

a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * * * *

"(j) *Definition of control.*—As used in this section the term 'control' means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." [Italics ours]

Other parts of the statute are set forth in the Appendix. (Exhibit "A")

STATEMENT

Evelyn F. Gregory, the petitioner, owned 5,000 shares being all the capital stock of the United Mortgage Corporation. She had purchased 3,300 shares in 1920 and 1921 for $180,000 and the remaining 1,700 shares in 1927 and 1928 for $170,000, her total cost thus being $350,000. (R. 13)

United Mortgage Corporation owned 1,000 shares of the capital stock of Monitor Securities Corporation, which had cost $10,413.07 in 1922 and was salable in 1928 at a profit. (R. 18, 22, 24) To reduce income taxes on the sale of the Monitor shares, especially the double tax which would result from a sale by the United company followed by a distribution of the proceeds to petitioner (R. 18), the following steps were taken:

On September 18, 1928, Averill Corporation was organized under the laws of Delaware. On September 21, 1928, United Mortgage Corporation transferred the 1,000 shares of Monitor stock to Averill Corporation, the latter in exchange issuing all of its own stock directly to the petitioner. On September 24, 1928, Averill Corporation was liquidated, petitioner receiving in such liquidation the 1,000 shares of Monitor stock. Petitioner thereupon sold the Monitor stock for $133,333.33. (R. 19)

In her tax return, petitioner treated the transfer of the 1,000 shares of Monitor stock by United Mortgage Corpora-

tion to Averill Corporation for its stock as a reorganization within section 112(i)(1) of the Revenue Act of 1928; the receipt by her of the Averill stock as a non-taxable distribution in reorganization under section 112(g); and the receipt by her of the 1,000 shares of Monitor stock upon liquidation of Averill Corporation as a distribution in liquidation taxable under section 115(c). She computed her gain on this liquidating distribution as follows:

The Monitor stock was valued at $133,333.33, being the sale price. From this she subtracted the sum of $57,325.45, thereby showing a profit on the liquidation of $76,007.88 taxable as capital net gain. She arrived at the cost figure of $57,325.45 (under section 113(a)(9) of the Revenue Act of 1928) by allocating to the Averill shares a proportion of the $350,000 original cost of the United Mortgage Corporation stock, computed by comparing the fair market value of the Averill shares when received by her with the fair market value of the United Mortgage Corporation shares on the same day. (R. 14, 22, 23)

Having reported a taxable profit of $76,007.88 upon receipt of the 1,000 shares of Monitor stock in liquidation of Averill Corporation, she reported no further gain upon the sale of the Monitor shares.

The Commissioner of Internal Revenue treated the transaction as an ordinary dividend of the Monitor stock to petitioner by United Mortgage Corporation, in the amount of $133,333.33. (R. 20)

The Board of Tax Appeals rejected the Commissioner's contention and, with an exception not here material, upheld the treatment shown in the taxpayer's return. (R. 8-11)

The Circuit Court of Appeals held that there was no reorganization under section 112(i)(1) and that the receipt of the Averill shares by petitioner was not a distribution in reorganization under section 112(g) but should be taxed to petitioner as an ordinary dividend in the amount of $133,333.33. (R. 52-56)

SUMMARY OF ARGUMENT

Believing that the decision below strikes at long-established doctrines of tax law; that it misconceives and largely frustrates the intent of Congress; that the proposed subjective tests of liability are defective and impracticable of application to concrete cases; that by substituting doubt for reasonable certainty it invites a flood of unnecessary tax litigation to the detriment alike of taxpayers and the Treasury; and that it tends completely to destroy a carefully laid legislative plan for the taxation of important transactions, counsel *amici curiae*, with the consent of the parties, respectfully submit this brief and request reversal of the decision of the Circuit Court of Appeals for the Seventh Circuit.

ARGUMENT

I

The term "reorganization" in section 112(g) should be construed according to the plain meaning of the definition in section 112(i)(1).

It is not disputed that, *if* the acquisition by Averill Corporation, under the circumstances in this case, of the Monitor shares being part of the property of United Mortgage Corporation (petitioner obtaining control of Averill Corporation) is a reorganization within the statute, the decision of the Board of Tax Appeals is correct and that of the Cirsuit Court of Appeals is wrong. The sole question is whether there was a "reorganization", as defined in section 112(i)(1).

The opinion of the Circuit Court of Appeals may be construed as holding that, although a purpose to reduce taxes does not control, the term "reorganization" is inapplicable to transactions not germane to the ordinary business activities of the participants even though falling directly within the definition, which is as follows:

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

"(1) The term 'reorganization' means * * * (B) a transfer by a corporation [United Mortgage Corporation] of all or a part of its assets [1,000 shares of Monitor stock] to another corporation [Averill Corporation] if immediately after the transfer the transferor or its stockholders [petitioner] or both are in control of the corporation to which the assets are transferred, * * *" [Revenue Act of 1928, Sec. 112]

"Control" is defined in section 112(j) as 80 per cent or more of the stock of a corporation.

The court below has interpreted the definition as though it concluded with this phrase:

"* * * *except* cases where such transfer is not germane to the particular trade or business"

It has long been settled that the words of an Act, if plain, control its application. In *United States v. Shreveport Grain & Elevator Company*, 287 U. S. 77, 83, this Court said, quoting from *United States v. Hartwell*, 6 Wall. 385, 396—

"If the language be clear it is conclusive. There can be no construction where there is nothing to construe."

To like effect, see *Texas & Pacific R. Co. v. United States*, 289 U. S. 627, 636, 638; *United States v. Standard Brewery, Inc.*, 251 U. S. 210; *Adams Express Company v. Kentucky*, 238 U. S. 190, 199. Construction presupposes ambiguity. (*Hamilton v. Rathbone*, 175 U. S. 414, 421) Though the intention of Congress is the object sought, the words of the Act, if plain, are "its only expositors". (*Pirie v. Chicago Title & Trust Co.*, 182 U. S. 438, 450; *United States v. Goldenberg*, 168 U. S. 95, 102)

These long-established doctrines apply "with peculiar strictness" to tax statutes. (*Old Colony R. Co. v. Commis-*

sioner, 284 U. S. 552, 560; *Crooks v. Harrelson*, 282 U. S. 55, 61) In the latter case, the Court said—

> "Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter *applies with peculiar strictness*. In *United States v. Merriam*, 263 U. S. 179, 187, 188, after saying that 'In statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used,' we quoted with approval the words of Lord Cairns in *Partington v. Atty. Gen.*, L. R. 4 H. L. 100, 122, that 'if the Crown, seeking to recover the tax, can not bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.'" [Italics ours]

Where, as in the present case, the Court is dealing with a highly *specific* portion of a tax statute the force of the literal language is even greater, as was recognized below both by the Board of Tax Appeals (*Gregory*, 27 B. T. A. 223, 225) and the Circuit Court of Appeals (*Helvering v. Gregory*, 69 F. (2d) 809, 810 (C. C. A. 2nd).

There are the strongest of reasons for holding that a *statutory definition* means precisely what it says. It is a warning to discard ordinary meanings and shows close legislative attention to the new meaning. In *Porter v. Commissioner*, 288 U. S. 436, 441, the Court considered the meaning of "net estate". The term was expressly defined in the statute. The Court held that other meanings were necessarily excluded.

Merritt v. Welsh, 104 U. S. 694, 702;
Selden v. Equitable Trust Co., 94 U. S. 419;
Warren v. Shook, 91 U. S. 704;

Slack v. Tucker, 23 Wall. 321;
Schweizer v. Mager, 297 Fed. 334 (D. C. N. D. Ill.);
Cothran v. United States, 276 Fed. 48 (D. C. W. D. Va.);
Candado Stevedoring Corp. v. Locke, 1 F. Supp. 456 (D. C. E. D. N. Y.).

This Court has been asked, not infrequently, to discard the plain language of revenue statutes but, so far as we can find, has uniformly declined to do so. One such case was *Crooks v. Harrelson*, 282 U. S. 55, 59, which involved a construction of the estate tax statute (Sec. 402, Revenue Act of 1918). The Court said—

> "It is urged, however, that if the literal meaning of the statute be as indicated above, that meaning should be rejected as leading to absurd results, and a construction adopted in harmony with what is thought to be the spirit and purpose of the act in order to give effect to the intent of Congress. The principle sought to be applied is that followed by this Court in *Church of the Holy Trinity v. United States*, 143 U. S. 457; but a consideration of what is there said will disclose that the principle is to be applied to override the literal terms of a statute only under rare and exceptional circumstances. The illustrative cases cited in the opinion demonstrate that to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. Compare *Pirie v. Chicago Title & T. Co.*, 182 U. S. 438, 451, 452. And there must be something to make plain the intent of Congress that the letter of the statute is not to prevail. *Treat v. White*, 181 U. S. 264, 268."

Others are *Lang v. Commissioner*, 289 U. S. 109, 113; *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 560; *Treat v. White*, 181 U. S. 264, 267; *United States v. Goldenberg*, 168 U. S. 95, 102, 103.

Helvering v. New York Trust Co., 292 U. S. 455, *Pinellas Ice & Cold Storage Company v. Commissioner*, 287 U. S.

462, and like cases, fall far short of authorizing the contradiction below. In the *New York Trust Company* case, a corporate trustee sold stock which it had received about a year previously from its customer, the trustor. The question was whether the stock had been "held * * * for more than two years" within section 206(a)(6) of the Revenue Act of 1921 so that the profit could be taxed at capital gain rates. The trustor had owned the stock for many years. The transfer to the trustee did not represent any disposition to outside interests. It was a mere step in an uncompleted gift to the trustor's son. The gift was to be completed when the son reached a certain age. The trustee contended that the two-year period should be computed by adding the tenure of the trustor. A later Revenue Act authorized tacking in such cases. The great object of Congress, admitted by all, was to afford relief to sellers of capital assets. Admittedly, the stock was such an asset unless it be held that the corporate trustee was so far removed from its customer, the trustor, as to require the stock to be classed as freshly-acquired property. Under the Revenue Act a trustee, though not a legal entity for all purposes, had some of the characteristics of a "taxpayer". Having regard to these facts and to the intent of Congress, a majority of the Court found a latent ambiguity in the phrase "held * * * for more than two years" and decided that the trustee was entitled to the benefit of the capital gains provisions.

A latent ambiguity by which an out-and-out *sale for cash* (payments deferred 120 days) might be taxed as a reorganization, may have been the condition precedent to construction in *Pinellas Ice and Cold Storage Company v. Commissioner*, 287 U. S. 462. There is a full discussion of the *Pinellas* case under a separate head of this brief.

In the present case, on the contrary, the words of the definition are clear. The court below does not suggest

ambiguity. The Board found none. We submit there is none. Neither of the cases mentioned control this case.

If it is relevant here, in the absence of ambiguity, to examine the settled administrative construction, it will be found that, until recently, the term "reorganization" has been applied according to the literal meaning of the definition. The administrative construction goes back to the Revenue Act of 1921 (Sec. 202(c)(2)) where the definition first appeared in its present form, exclusive of an important phrase added in 1924 which will later be mentioned, and is shown in the official Regulations, the published rulings of the Commissioner of Internal Revenue, and the reported decisions of the Board of Tax Appeals.

Regulations 74, issued under the Revenue Act of 1928, provides:

> "**Art. 574. Exchanges in connection with corporate reorganizations.**
>
> * * * * * * *
>
> If two or more corporations reorganize, for example, by—
>
> * * * * * * *
>
> "(4) *The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X corporation or its shareholders or both are in control of the Y Corporation*—
>
> then no taxable income is received from the transaction by the X Corporation * * * if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of * * * the X Corporation * * * if the sole consideration received by the shareholders is stock or securities of the Y Corporation.
>
> "If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Cor-

poration and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.)" [Italics ours]

Let X designate United Mortgage Corporation and Y the Averill Corporation and the present transaction is squarely within the Regulations.

See also Article 577 of the same Regulations.

There were similar provisions in the Regulations under the Revenue Acts of 1926 and 1924, the latter being the Act where the statutory definition of "reorganization" first assumed the same form as in the Revenue Act of 1928. (See Regs. 69 and 65, Arts. 1574 and 1577)

The literal application of the definition by the Commissioner of Internal Revenue and by the Board of Tax Appeals in particular cases is shown by:

Published Rulings:

I. T. 2530, IX-1 C. B. 194;
G. C. M. 7285, IX-1 C. B. 181;
G. C. M. 3827, VII-2 C. B. 114;
G. C. M. 2579, VII-1 C. B. 198.

Decisions of Board of Tax Appeals:

Stires Corp., 28 B. T. A. 1;
Holmby Corp., 28 B. T. A. 1092;
Green, 24 B. T. A. 719;
National Pipe & Foundry Co., 19 B. T. A. 242, 250;
First Nat. Bank of Champlain, 21 B. T. A. 415;
Tulsa Oxygen Co., 18 B. T. A. 1283.

Since 1924, and in the light of this uniform administrative construction, Congress has successively reenacted (and enlarged) the definition of "reorganization". (Sec. 203 (h)(1), Revenue Act of 1924; Sec. 203(h)(1), Revenue Act of 1926; Sec. 112(i)(1), Revenue Act of 1928) The 1928 Act is the statute before this Court. These repeated reenactments show Congressional adoption of the administrative construction of the definition according to the literal meaning of the words.

Massachusetts Mutual Life Insurance Co. v. United States, 288 U. S. 269;
Old Colony R. Co. v. Commissioner, 284 U. S. 552;
Poe v. Seaborn, 282 U. S. 101;
Wisconsin v. Illinois, 278 U. S. 367, 413;
United States v. Hermanos, 209 U. S. 337;
United States v. Falk, 204 U. S. 143.

If we examine the circumstances of the enactment and its antecedent history (*Karnuth v. United States,* 279 U. S. 231, 243; *United States v. Katz,* 271 U. S. 354, 357; *American Tobacco Co. v. Werckmeister,* 207 U. S. 284, 293) the conclusion that the definition should be taken to mean what it says is still further confirmed.

Throughout the Commissioner's argument runs the assumption that Congress, in laying down the definition of "reorganization", was not well informed on the subject. He believes the legislature was grappling with a new and elusive problem, the details and concrete solutions of which, at the time, were obscure and largely unrecognized. Under the circumstances, Congress is assumed to have been unable to state its plan in precise detail. It could legislate, argues the Commissioner, only in terms of broad policy, leaving to the courts the working out of concrete solutions in particular cases. The conclusion is drawn that the literal words of the definition may well fail to express the real intent in a particular case—for example, in this case.

That result might well follow if the Commissioner's assumptions were correct. But they are not correct. The circumstances and history of the definition of "reorganization" are discussed in detail under Point III of this brief but may profitably be outlined here.

So-called "reorganization" tax problems are neither recent nor unique. They were active as early as the Revenue Act of 1909. (*United States v. Alpha Portland Cement Co.,* 257 Fed. 432 (D. C. E. D. Pa.), reversed 261 Fed. 339 (C. C. A. 3rd)) Two of the five principal "reorganization"

cases in this Court arose under the Revenue Act of 1913. (*Rockefeller v. United States,* 257 U. S. 176; *United States v. Phellis,* 257 U. S. 156) The three remaining cases involved the Revenue Act of 1916. (*Marr v. United States,* 268 U. S. 536; *Weiss v. Stearn,* 265 U. S. 242; *Cullinan v. Walker,* 262 U. S. 134) The tax treatment of "reorganization" has had a great many years of study and analysis.

By 1921, the Treasury had enjoyed the benefit of twelve years of active experience with these problems. It had dealt with thousands of concrete cases. Dozens of rulings and opinions had already been published. Some are collected in Exhibit "B" attached. The unpublished rulings were much more numerous. The Treasury had a vast fund of experience, data, and solutions in particular cases. For years it was, and still is, the great clearing house of information on every aspect of "reorganization" and the sole possessor of accurate concrete knowledge of *all phases of the problem.* It was well prepared to announce its conclusions in 1921.

In the light of this experience, *the Treasury experts prepared the original draft of the Revenue Act of 1921. This is the rich background of the definition of "reorganization".* Dr. Thomas S. Adams and the other Treasury experts sat with Congress and its fiscal committees throughout the entire course of the legislation. They counseled with the legislators daily. Each provision was a "bloody battle ground" gone over inch by inch by the Committees and by the Houses of Congress. Each clause was intensively considered and studied. Concrete amendments were proposed, debated, and accepted or rejected. The original definition prepared by the Treasury experts was reshaped to fit into the crystallized detailed Congressional plan. (See Exhibit "C" attached) The refined product was duly enacted.

It is instructive to note, as showing the careful discrimination in the tax statute, that "reorganization" was em-

ployed in the profits tax statutes of 1918 and 1921, with an entirely different meaning. (Revenue Acts of 1918 and 1921, Sec. 331)

The same legislative procedure was repeated in 1924, but with the benefit of three more years of experience. Further study by the Treasury experts and further legislative consideration resulted in certain modifications, mainly by way of *enlargement* of the statutory concept of "reorganization". The definition reached maturity in the Revenue Act of 1924. It was reenacted without change in the Revenue Acts of 1926 and 1928. It is very plain that the definition was not at all an attempt to express a merely general policy. *It was a specific definition developed from concrete cases.* And Congress was indeed well informed.

Much of the argument to disregard the definition is based, we believe, on a failure to understand the function the term "reorganization" performs in the statute. By itself "reorganization" is meaningless. Standing alone, it determines neither the taxability of a gain (G. C. M. 3110, VII-1 C. B. 51), the deductibility of a loss, nor any other tax problem. Gain or loss depends upon particular subsections of section 112. (See Sec. 112 (b)(3), (b)(4), (c), (d), and (e)) Questions of basis are determined by section 113. (See Sec. 113(a)(6) and (a)(9) and Sec. 114(a)) Distribution problems are determined under sections 112, 113, and 115. (See Sec. 112(d)(1), (d)(2), (g), and (h), Sec. 113(a)(9), and Sec. 115(c)) Questions of capital gains or losses are determined by section 101. (See Sec. 101(c)(8)(A), (B), and (C)) The definition is merely a convenient description to which reference is made in other parts of the Act dealing specifically with the various classes of problems involved. The same yardstick—the definition of "reorganization"—applies to all of these problems. A narrow construction in a gain case means a broad construction in a loss case or in a case involving basis, certain types of distribution, or capi-

tal losses. It is indeed a superficial view of the statutory scheme to restrict the definition so as to tax a particular gain when by so doing exactly the opposite effect is produced in a loss case, a basis case, or some other kind of a case.

When it is recognized that the definition is simply a unit of measurement—a carefully calculated yardstick—applicable alike to numerous classes of cases, sometimes invoked to the benefit of the Treasury and sometimes by the taxpayer, the error of another argument becomes apparent. The Commissioner refers to the reorganization provisions as "exemptions" or as providing "exceptional treatment"; hence requiring strict construction. But, as we have seen, a narrow construction favors the Treasury in one case, and the taxpayer in others. In effect, as it seems to us, the Commissioner says that the yardstick ought to be 35 or 37 inches, whichever produces the greater tax. Justice can not be produced by distorting the unit of measurement. The net results are mixed and wholly beyond prediction.

There is a more fundamental objection. Even in a gain case like the present, no "exemption" is involved. The "reorganization" provisions simply authorize complete or partial *deferment* of present taxation. This deferment, let it be noted, is conditioned upon *an extra burden of future tax.* In the present case, for example, when Mrs. Gregory sells her *United* stock she will pay tax on the $57,325.45 portion of the proceeds, taxation of which is presently deferred. (Revenue Act of 1928, Secs. 111(a) and 113(a)(9)) Comparing the low tax rates in 1928 with the high rates at the present time and in prospect for the future, it is quite possible that the Government will receive more, rather than less, taxes from her because of the reorganization provisions. To characterize these nicely-calculated self-compensating *deferment* provisions as "exemptions" or "favored treatment" and for that reason subject to a narrow construction is utterly to misunderstand the statute.

Based upon an examination of the statute and a few of the principal circumstances attending its passage, the following appears:

First: In the absence of ambiguity—and there is none here—the settled rules of construction, applicable with "peculiar force" to tax cases, call for a literal application of the definition.

Second: The unusually specific terms of the definition must be read as a legislative command to follow its clear language.

Third: The Court is construing a *definition.* Congress proposed to exclude all other meanings. Powerful reasons stand in the way of amendments or substitutions under the cloak of construction.

Fourth: The definition came from the Treasury. As the product of a decade of experience and of intensive consideration and shaping by well-informed legislators, the studiously composed language fully deserves to be the sole measure of its own scope and application.

Fifth: The definition is a yardstick which, by itself, does not determine tax liability. By virtue of other parts of the Act, however, it affects many types of cases. In a gain case a narrow construction of "reorganization" favors the Treasury, *but in a loss or basis case it favors the taxpayer.* The same definition can not be narrow in one case and broad in another. Considerations of "equity", if such exist in tax matters, should certainly not be resolved by changing the unit of measurement. Its great value lies in its unvarying dependability. The plain meaning of plain words is the best guide to that end.

Sixth: "Reorganization" is at the root of a well considered Congressional scheme for tax *deferment* in selected types of cases. The Court is not dealing with "exemption" or "special treatment". It is misleading to urge a narrow construction upon that ground. With increasing frequency these days the reorganization sections mean more tax rather

than less. The self-compensating provisions which insure the orderly functioning of the selective deferments, require that the integrity of the unit of measurement be maintained. The yardstick should be taken at its face value.

II

A purpose to reduce taxes is immaterial, provided the transaction otherwise falls within the statutory definition of "reorganization".

Despite certain passages in the opinion, the decision below has generally been interpreted as holding that a purpose to reduce or avoid taxes may render the statute inapplicable to a transaction even though plainly within its terms.

Since *United States v. Isham,* 17 Wall. 496 (1873), it has been settled doctrine that a purpose to reduce or avoid taxation is immaterial to tax liability. As this Court said in *Superior Oil Co. v. Mississippi,* 280 U. S. 390, 395–396, involving a transaction the sole purpose of which was to escape taxation—

> "The fact that it desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you intentionally may go as close to it as you can, if you do not pass it. *Bullen v. Wisconsin,* 240 U. S. 625, 630, 631."

To like effect, see *United States v. Phellis,* 257 U. S. 156, 172; *Bullen v. Wisconsin,* 240 U. S. 625. Among numerous decisions in the courts below, see—

Wiggin v. Commissioner, 46 F. (2d) 743 (C. C. A. 1st);
Brunton v. Commissioner, 42 F. (2d) 81 (C. C. A. 9th);
Iowa Bridge Co. v. Commissioner, 39 F. (2d) 777 (C. C. A. 8th);
Bing v. Bowers, 22 F. (2d) 450 (D. C. S. D. N. Y.);

Fraser v. Nauts, 8 F. (2d) 106 (D. C. N. D. Ohio);
Weeks v. Sibley, 269 Fed. 155 (D. C. N. D. Texas).

The same rule is found in the decisions of the Board of Tax Appeals:

Fruit Belt Telephone Co., 22 B. T. A. 440, 441, 442;
Houston Bros. Co., 21 B. T. A. 804, 813;
Brackett, 19 B. T. A. 1154, 1159, 1160;
Harkness, 1 B. T. A. 127;

and the rulings of the Commissioner of Internal Revenue:

S. O. 149, II-1 C. B. 20, 23;
L. O. 1062, 4 C. B. 168, 171.

As this Court said in *United States v. Phellis*, 257 U. S. 156, 172, a reorganization case arising under an early Revenue Act, "In such matters, what was done, rather than the design and purpose of the participants, should be the test". (*Remington Rand, Inc. v. Commissioner*, 33 F. (2d) 77 (C. C. A. 2nd), cert. den. 280 U. S. 591; *Harkness*, 1 B. T. A. 127; *Brackett*, 19 B. T. A. 1154, 1159, 1160)

By successive reenactments this salutary doctrine has become part and parcel of the statute.

Massachusetts Mutual Life Insurance Company v. United States, 288 U. S. 269;
Old Colony R. Co. v. Commissioner, 284 U. S. 552;
Poe v. Seaborn, 282 U. S. 101;
Wisconsin v. Illinois, 278 U. S. 367, 413.

If tests of tax liability are to become subjective instead of objective, if intent is to be raised to a position of controlling importance, the highly essential factor of certainty which mainly makes administration of the law possible disappears. Courts are familiar with the manifold difficulties of proving intent.

Moreover, there is no stopping place between the doctrine of the foregoing cases—that intent is immaterial—and the

novel concept that each taxpayer owes a duty so to fit his transactions into the Revenue Act as to produce the *greatest* amount of tax. Standards of liability based on an "average" transaction, a "fairly conducted" transaction, or a "strictly business" transaction, are imaginary to the point of hopeless impracticability.

Under the decision below, is tax avoidance involved in the purchase of tax-exempt Government bonds? What if a profitable sale is rejected because of the tax burden? If property is sold at a loss to offset other income? Should a trustee, guardian, or director heed the command of the State law to conserve the property in his custody or that of the Federal law if it requires him to pay a maximum tax?

We can not believe the Commissioner proposes seriously to argue that the Court abandon its traditional doctrine. If he does, the above decisions, and the reasons on which they are based, afford a complete answer.

III

The decision below defeats the intent of Congress.

In the first place, the law is clear that intent is primarily to be sought in the statute itself.

> *Thompson v. United States,* 246 U. S. 547, 551;
> *Pirie v. Chicago Title & Trust Co.,* 182 U. S. 438, 450;
> *Treat v. White,* 181 U. S. 264, 267;
> *Merritt v. Welsh,* 104 U. S. 694, 702.

There is nothing in the Act to support the finding of the Circuit Court of Appeals that Congress intended anything to depend on whether a given transaction was "germane". The court, we think, has fallen into the error of substituting conjecture for plain language.

If the purposes of Congress are sought in extraneous sources (*United States v. Dubilier Condenser Corp.,* 289 U. S. 178, 205, 206, 218, 220, 222; *United States v. Mo. Pac.*

R. Co., 278 U. S. 269, 279; *United States v. St. P. M. & M. Ry. Co.*, 247 U. S. 310, 318, 319; *Binns v. United States*, 194 U. S. 486, 495) positive evidence will be found that Congress meant what it said in the statutory definition of "reorganization". Congress proposed to *include* non-germane transactions.

(a) *Nature of "reorganization" problems.*—It is probably unfortunate that Congress selected the word "reorganization" instead of "readjustment" or some other term having no fixed meaning in the law. Despite the defined meaning of "reorganization", there is a disposition to associate the tax concept with other concepts of "reorganization". As employed in the tax statute, the term is much broader than in other fields. A correct understanding may be promoted by considering briefly the nature and scope of the problem in tax cases.

The American concept of income, unlike the English (S. Rept. 275, 67th Cong., 1st Sess., p. 13), includes the recognition of gains and losses from the sale or other disposition of capital assets.

> *Merchants' Loan & Trust Co. v. Smietanka*, 255 U. S. 509;
> *Hays v. Gauley Mountain Coal Co.*, 247 U. S. 189.

Where the asset is *sold* the problem of taxation is not especially difficult. Where the asset is *exchanged*, the computation of gain or loss uniformly requires the valuation of the asset received. In many instances valuation is difficult; in some, practically impossible. Valuation has been a very troublesome problem to the Bureau of Internal Revenue. (*Hearings on H. R. 8245 (Revenue Act of 1921) before Senate Finance Committee*, 67th Cong., 1st Sess., Sept. 1-Oct. 1, 1921, pp. 27-28, referred to hereafter as *"Senate Hearings, 1921 Act"*)

Further complications arise upon exchanges, frequently of stock or securities, which do not involve final disposi-

tions to outside interests. In these cases, the property received is not essentially different from the property disposed of. Technically, gain or loss has been realized, but this is only true in a very formal sense. These sorts of exchange are found frequently in "reorganizations". How should they be taxed?

The general scope of "reorganization" problems from a tax standpoint may be outlined by starting with the simple case of an individual who incorporates his business. He exchanges property (assets of the sole proprietorship) for stock of a new corporation. A partnership may be incorporated. A corporation may turn over all or part of its assets to another corporation for stock which is retained by the transferor or distributed to its stockholders. Several corporations merge, consolidate, or transfer part of their properties to one or more new corporations for stock which is retained by them or distributed to their stockholders. Instead of acquiring property, the new corporation may acquire all or part of the stock of one or more old corporations in exchange for its own stock, thereby creating the relation of parent and subsidiaries. A corporation reincorporates or makes other changes in its capital structure involving exchanges of securities.

Particular illustrations of typical "reorganization" problems will be found in *Marr v. United States,* 268 U. S. 536; *Weiss v. Stearn,* 265 U. S. 242; *Cullinan v. Walker,* 262 U. S. 134; *Rockefeller v. United States,* 257 U. S. 176; *United States v. Phellis,* 257 U. S. 156; published rulings of the Bureau of Internal Revenue attached as Exhibit "B", and Articles 572-580, 591, 597-601, 625, 628, and 629 of Regulations 74 (issued under the Revenue Act of 1928).

In many of these cases there has been, at most, a formal exchange; gain or loss has only technically been realized. Property has been received, but the tax must be paid in cash.

(b) *Congress was well informed on the subject.*—The

problems of gain, loss, and basis involved in the tax treatment of "reorganization" exchanges are not of recent origin. As stated under a previous branch of the Argument, they go back at least to the Revenue Act of 1909. The Treasury had a decade of experience with "reorganization" prior to the first legislation on the subject in the Revenue Act of 1918 (Sec. 202(c)(2)). Under the prior Acts, gain and loss were fully recognized, formal exchanges being treated the same as all other exchanges. The fact of subsequent legislation shows that this treatment was considered unsatisfactory.

Section 202(c)(2) of the Revenue Act of 1918 covered but a small portion of the field. Nevertheless, it furnished a beginning. The Treasury had numerous cases involving all aspects of the reorganization problem presented to it in the returns under the great War Revenue Acts of 1917 and 1918. (See Exhibit "B") The problems, one by one, were subjected to analysis and appropriate solutions were worked out by Treasury experts. The Treasury was the great clearing house of information on "reorganization". Within the Treasury the problem could be viewed in its entirety. This was a unique advantage which the courts do not enjoy.

The Treasury was convinced that treatment by judicial or administrative methods, unaided by legislation, was inadequate. The courts had not gotten beyond the cases under the 1913 and 1916 Acts. As late as 1921, the only final decisions on "reorganization" were *Rockefeller v. United States,* 257 U. S. 176, and *United States v. Phellis,* 257 U. S. 156, both decided two days before the 1921 Act was signed and both dealing with the 1913 law.

Administrative treatment by rules or regulations was discarded, in large part because of uncertainty as to their legal status.

Congress early settled upon the policy of placing in the statute itself such of the policies and solutions worked out by the Treasury Department as were approved by the

legislators. Dr. Adams, an able advisor of the Treasury Department, stated on September 1, 1921, to the Committee on Finance of the Senate (*Senate Hearings, 1921 Act,* p. 24)—

> "DR. ADAMS. We should have a statutory rule. The old rule was simpler than the one proposed, but in view of the decisions referred to we feel that the proposed rule is the right one, and perhaps the only safe one. We should take no chances with a rule which the courts might upset.
>
> "THE CHAIRMAN. Has it not been the policy to bring these things within the law, so that they will be fixed and settled?
>
> "DR. ADAMS. Yes."

Treasury policy developed rapidly. In 1921, the Treasury was prepared to submit its views to Congress. *The Treasury prepared the first draft of the Revenue Act of 1921,* a fact of prime importance in this case. (*Hearings on Internal-Revenue Revision before House Committee on Ways and Means,* 67th Cong., 1st Sess., July 26-29, 1921, p. 406; *Senate Hearings, 1921 Act,* p. 4)

Moreover, Dr. Adams and other Treasury experts collaborated "with the House Committee * * * throughout their entire work on the bill". (*Senate Hearings, 1921 Act,* p. 4) J. S. McCoy, Treasury Actuary, and John E. Walker, Chief, Legislative Drafting Service, United States Senate, were also in attendance upon the Committee on Finance of the Senate. (*Senate Hearings, 1921 Act,* p. 3)

It was the settled policy of these Committees to examine all the details of the revenue bills referred to them. The Chairman of the Committee on Finance of the Senate said (*Senate Hearings, 1921 Act,* p. 21)—

> "THE CHAIRMAN. Those who were very active in the last bill know that pretty nearly every one of these paragraphs is a bloody battle ground. We fought every inch of it.
>
> "DR. ADAMS. This one will be particularly—

"SENATOR LA FOLLETTE. Gory?

"DR. ADAMS. I do not know whether it will be gory or not."

That Congress was well informed and acted advisedly in formulating its precise and detailed policy for the tax treatment of reorganization exchanges and related problems can not be seriously questioned.

(c) *A major purpose, wholly defeated by the decision below, was to disallow non-germane losses.*—Some of the purposes of the Treasury in connection with "reorganization", adopted by Congress, were stated by Dr. Adams, the Treasury Advisor, as follows (*Senate Hearings, 1921 Act,* p. 29):

> "DR. ADAMS. The change is recommended because, in the first place, it is difficult to make appraisals. In the average reorganization, or in many reorganizations, there is no definite, fixed market price for the securities. That is one reason. In the second place, it is possible to avoid the tax by the use of no par-value stock. In the third place—and this is the most important reason—where any heavy tax is involved the reorganization is held up. They do not do it. All kinds of business readjustments have been stopped. *Finally this process is now being indulged in to register losses.* When they could make heavy gains, which would subject them to a heavy tax, the transaction is blocked. *On the other hand, where losses are to be registered, there is an additional incentive to make the reorganization.* But the principal defect of the present law is in blocking desirable business readjustments." [Italics ours]

To the same effect, see the report of the Committee on Ways and Means (H. Rept. 350, 67th Cong. 1st Sess., p. 10) and the report of the Committee on Finance (S. Rept. 275, 67th Cong., 1st Sess., p. 11). The pertinent portion of the latter report is quoted in Exhibit "C".

The decision below utterly defeats the purpose to wipe out colorable losses in fictitious exchanges. The facts

of the present case need be changed but slightly to illustrate the point. Assume the assets of United Mortgage Corporation had depreciated so that by 1928 the stock which cost petitioner $350,000 was worth but $100,000. Suppose petitioner desired to "register" the loss, without, however, finally disposing of the United stock. Assume she organized Averill Corporation and caused all the United assets to be transferred to it, she exchanging her United stock for Averill stock. The transaction would be even less "germane" to business activities than the transaction as it actually occurred in this case. For obvious reasons, loss transactions are notoriously *non*-germane. If the definition of "reorganization" is literally applied, petitioner's loss would be disallowed under section 112(b)(3) and full effect would be given to the intent of Congress. But if the definition is subject to the "germane" restrictions read into it by the court below, *the non-germane loss would be allowable* under section 111(d) and a primary purpose of Congress *defeated.*

This, then, is the effect of the decision below: *It opens the door wide to the allowance of non-germane losses and thereby defeats the intent of Congress that such losses be denied.* Congress had to defer non-germane gains in order to block non-germane losses (the illustrative case). It was perfectly willing to do this and said so in plain words. As this Court pointed out in *Van Camp & Sons Company v. American Can Co.*, 278 U. S. 245, 253, to depart from plain language is to invite the danger of "relieving from the grasp of the statute some [cases] * * * the legislature definitely meant to include". That is the effect of the decision below.

(d) *The intent of Congress to promote certainty is defeated.*—The intent to provide certainty and definiteness is so obvious from the reports of the House Ways and Means Committee (H. Rept. 350, 67th Cong., 1st Sess.) and the Senate Finance Committee (S. Rept. 275, 67th Cong.,

1st Sess.) on the 1921 Act as to require no argument. See, in addition, the report of the Committee on Finance on the 1924 Act, S. Rept. 398, 68th Cong., 1st Sess. Litigation thrives on uncertainty and Congress wished to diminish tax litigation. See report of the Committee on Finance on the 1928 Act, S. Rept. 960, 70th Cong., 1st Sess., pp. 16-17.

The injection of unexpressed qualifications into the clear language of the statute shakes confidence in the integrity of the definition and in the Act generally. That which was certain becomes conjectural. Every important tax return becomes a potential law suit. Neither the income tax officers nor the courts could cope with such a flood of litigation. Over-zealous administrators are invited to visit liabilities upon transactions squarely within the Act. Business can not proceed on such a basis and Congress did not intend that it should be compelled to do so.

It is pertinent to inquire whether all of the 50 or more definitions in the Act possess powers of expansion and contraction such as those attributed below to "reorganization". Also, if words can be modified to impose a tax, can not they also be modified to escape tax—and thus produce the avoidances the court below desired to stop? Can fraud penalties or indictments be successfully maintained where the clear words of a tax statute fail to disclose its true meaning? These are but a few of the consequences of uncertainty. Congress wished to avoid all of them.

(e) *The purpose to avoid unnecessary valuations is defeated.*—It will be recalled that the administrative difficulty of valuation was an important reason for the adoption of the reorganization provisions. If the scope of the definition is narrowed by construction, the necessity of valuations is correspondingly increased and this is true in loss cases as well as gain cases. The purpose to avoid unnecessary valuations can be accomplished by giving full effect to the words of the definition. It is defeated, in substantial part, by the decision below.

(f) *The 1924 Act indicates that Congress intended to include the present case.*—The general definition, as we have seen, goes back to the 1921 Act. But the particular clause which covers the present case was added in the 1924 Act, and is as follows:

> "(1) *The term 'reorganization' means*
>
> * * * * * * * *
>
> *(B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,* * * * "[Revenue Act of 1924, Sec. 203(h)(1)—Italics ours]

In 1924, as in 1921, the Treasury prepared the first draft of the Act. Its Revision Board had devoted the entire summer to the bill. The experts worked constantly with the Committees of Congress. (*Hearings on Revenue Revision, 1924, before House Ways and Means Committee,* 68th Cong., 1st Sess., Jan. 14-19, 1924, pp. 112-114, 175-179, 456-457, 469-470)

The specific clause of the definition which covers the present case thus originated with the Treasury Department. Moreover, the unqualified addition of the clause to the definition in 1924 shows that legislative attention was specifically called to the kind of a transaction now before the Court and that Congress decided it should be *included.* The absence of any words restricting the new clause to transactions germane to business strongly indicates that Congress intended no such limitation.

(g) *Congress considered that the prescribed adjustments to basis in section 113 constituted sufficient safeguards.*—The reorganization *definition,* as we have seen, has no effect in itself on gain, loss, basis, or any other question. Detailed subsections elsewhere throughout the Act provide the solutions to these problems.

A careful study of the various subsections of section 112 (gain or loss) and 113 (basis) will show that they are closely interrelated. The operation of section 113(a)(6), which prescribes basis in the case of tax-free exchanges, is conditioned upon section 112(b) to (e), which deal with gain or loss. "Reorganization" provides for *deferment*—not avoidance—of both gains and losses, *conditioned upon adjustments to basis under section 113.*

This is what Congress meant when, as shown in the Committee reports on the Revenue Act of 1921 (H. Rept. 350, 67th Cong., 1st Sess., p. 10; S. Rept. 275, 67th Cong., 1st Sess., p. 12; H. Rept. 179, 68th Cong., 1st Sess., p. 7; S. Rept. 398, 68th Cong., 1st Sess., p. 7), it said that the basis provisions afford proper safeguards against the misuse of the reorganization provisions. Congress recognized fully the fact that these provisions might be employed by taxpayers in transactions not germane to ordinary business activities and was entirely willing that this should be done relying, among other reasons, upon the fact that ultimately, *by virtue of adjustments to basis,* a sufficiently full measure of tax would be secured.

The decision below defeats the intent of Congress because it fails to observe that the legislators intended to rely on adjustments to basis to check abuse. They did not wish protection by any warping of the definition.

Had Congress considered that the present case, as contended by the Government, was an evasion, it would have promptly amended the definition, as it amended in 1923 the closely related provisions of section 203(b)(1). (c. 294, Sec. 1, 42 Stat. 1560)

IV

The literal application of the definition produces a reasonable result.

When the stock of Averill Corporation was distributed to petitioner, after receipt by that corporation from United Mortgage Corporation of the Monitor stock, petitioner's original basis for gain or loss on the United Mortgage Corporation stock in the amount of $350,000 was allocated, under the provisions of section 113(a)(9) of the Revenue Act of 1928, between the United Mortgage Corporation stock and the Averill Corporation stock, in accordance with the respective fair market values of these stocks, as follows:

Portion of original basis allocated to United Mortgage Corporation stock	$292,674.55
Portion of original basis allocated to Averill Corporation stock	57,325.45
Total original basis of United Mortgage Corporation stock	$350,000.00

Giving the words of the Act their literal meaning, the present effect of the transaction is to permit petitioner to subtract from the $133,333.33 value of the Monitor stock received by her on liquidation of Averill Corporation, the allocated basis figure of $57,325.45 and thus to show a taxable profit at the liquidation of $76,007.88, instead of the gross proceeds, or $133,333.33.

The court below apparently failed to see that the basis on the United Mortgage Corporation stock owned by her was *ipso facto* reduced by the same sum of $57,325.45—*i.e.*, from $350,000 to $292,674.55. The reduction of the basis of the United stock is the safeguard which Congress deemed sufficient to prevent misuse of the reorganization provisions and to make unnecessary any restriction of reorganization to germane business transactions.

Obviously, the statutory scheme, as applied to this case, conforms to good business practice. Disregarding, for a

moment, the mechanics of the transaction, what Mrs. Gregory did was to sell part of the capital assets owned by her for $133,333.33. The Government insists that the measure of taxable income from that transaction is *the gross proceeds of the sale.* Mrs. Greogry's position is that she should be allowed to subtract from the gross proceeds a fair amount representing the cost or other basis of the asset she sold. Her position is plainly reasonable. (Compare *Commissioner v. Logan,* 283 U. S. 404) Whenever a capital asset is sold, a proper amount representing the cost of the asset should be deducted from the sale price to determine the taxable profits. This is what the statute, construed in accordance with the literal meaning of the plain words employed, permits.

A homely illustration will make the *substance* of the transaction plain. A farmer purchases ten bushels of corn at $1 a bushel. He sells two bushels for $3.50. The Government says his income is $3.50. Mrs. Gregory says his income is $1.50.

The reduction of the gross proceeds from a sale by a reasonable element of cost is not only the fair way to arrive at net income but is entirely in line with the purpose of Congress in the 1921 and later Acts to expedite capital transactions.

The foregoing exposes the Government's bold assertion that petitioner is trying to avoid tax on an "ordinary dividend".

V

Pinellas Ice & Cold Storage Company v. Commissioner, 287 U. S. 462, requires reversal of the decision below.

The consistent administrative construction of the definition according to its literal meaning has already been shown. In *Pinellas Ice & Cold Storage Company v. Commissioner,* 287 U. S. 462, the Court disapproved a restricted construction placed upon the definition by the Circuit Court of Appeals of the Seventh Circuit, saying (page 469):

> "But the construction which the court seems to have placed upon clause A, paragraph (h) (1), § 203, we think is too narrow. It conflicts with established practice of the tax officers and if passed without comment, may produce perplexity."

Evidently the Court's purpose was, *first*, not to disturb the established practice of the tax officers and, *second*, not to introduce elements of perplexity. Both of these objects are entirely in accord with a correct construction of the definition and of the intent of Congress. All of the arguments heretofore advanced in this brief squarely support the above quoted portion of this Court's opinion in the *Pinellas Ice & Cold Storage Company* case.

The facts were that an ice company in Florida had transferred all of its property to a new corporation for short-term four-months purchase-money notes and cash. This Court said (page 468)—

> "These notes—mere evidence of obligation to pay the purchase price—were not securities within the intendment of the act and were properly regarded as the equivalent of cash."

With this conclusion we have no difference. We agree that—

> "It would require clear language to lead us to conclude that Congress intended to grant exemption to one who sells property and for the purchase price accepts well secured, short term notes, (all payable within four months) when another who makes a like sale and receives cash certainly would be taxed." [Page 469]

Obviously, this Court was directing its reasoning, not to clause (A) of the definition of "reorganization" (which makes no point whatever of "securities"), but to section 203(b)(3) of the Revenue Act of 1926, which states that no gain or loss shall be recognized where properties are exchanged in reorganization solely for stock or securities, and

to section 203(e), which takes care of the situation where money is involved. It would be a distortion to say that the above-quoted language has anything to do with the definition of "reorganization".

Admittedly, some element of continuity of interest underlies the statutory scheme. It does not underlie the *definition of "reorganization"*. This continuity of interest is not expressed in the definition but in the requirements of section 203(b)(3) and other subsections of that section (section 112 in the 1928 and later Acts) that the consideration consist of securities. The four-months notes did not provide the necessary continuity of interest contemplated by section 203(b)(3). Perhaps six-months notes might have been sufficient. This element of continuity finds its expression in the nature of the "securities" received. Short-term notes were insufficient to afford the necessary continuity. Here again it is section 203(b)(3), not the definition, that is involved.

The foregoing reasoning was adequate to dispose of the entire case and we believe it was so intended by the Court. The Court's reasoning was substantially that of the Board of Tax Appeals, which held against the taxpayer on the very proper ground that this particular kind of a note was not a "security". Indeed, at one place in the opinion, the Court seems to say that it agrees with the position of the Board for the Court states (page 468) that the Board "accordingly and as we think properly, upheld the Commissioner's action".

It must be said, however, with regret, that the *Pinellas* decision has caused considerable confusion, as evidenced by most of the recent decisions of the Board of Tax Appeals and the courts. (See cases cited in the brief of the Commissioner in this case, especially on page 21) The confusion arose out of what appears to be merely a dictum in the *Pinellas* opinion. Endeavoring to make clear that the court below had unduly restricted the definition, this Court, having already disposed of the case, proceeded to show

that a restricted definition was unjustified. In so doing, this Court let fall the observation (page 469) that, in the circumstances, it approved the conclusion below "that the facts disclosed failed to show a '*reorganization*' within the statutory definition". What the Court apparently had in mind was that even if the facts fell within the definition of "reorganization", and we think they did, nevertheless the gain should be recognized because the notes were not securities and the gain, therefore, was not within the protection of section 203(b)(3) and (e). This view of the Court's decision harmonizes with the announced purpose to confirm the settled administrative practice, the desire to avoid perplexity, and the real function of the definition of "reorganization" as a fixed and reliable yardstick which is used to define specific tax results in many other parts of the statute.

The confusion attending what we think is a misinterpretation of a dictum in the Court's opinion in the *Pinellas* case is an excellent illustration of the troubles which follow distortion of the statutory unit of measurement of "reorganization".

Conclusion

In conclusion it is submitted that—

(1) Under settled doctrines of construction, the definition must be given a literal interpretation.

(2) Any theory of interpretation based upon the taxpayer's intent or motive is impractical and unsound.

(3) Congress was fully familiar with the problems involved, and its policies were written into the statute with exceptional care.

(4) The interpretation proposed by the Commissioner is contrary to the intent of Congress and established administrative practice, and will produce confusion, uncertainty, and perplexity.

(5) The interpretation we urge was intended by Congress; protects the revenues against non-germane losses; conforms to established administrative practice; and affords certainty to both the Government and taxpayers.

The decision below should be reversed.

Respectfully submitted,

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EDWARD H. MCDERMOTT,
Counsel Amici Curiae.

APPENDIX

EXHIBIT "A"

CERTAIN PROVISIONS OF THE REVENUE ACT OF 1928, C. 852, 45 STAT. 791-883.

SEC. 101. CAPITAL NET GAINS AND LOSSES.

* * * * * * * * *

(c) *Definitions.*—For the purposes of this title—

* * * * * * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112(g) of this title or under the provisions of section 203(c) of the Revenue Act of 1924 or 1926, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) *Adjustment of basis.*—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item, properly chargeable to capital account, and

(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws; but in no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value under section 114(b)(2) or to percentage depletion under section 114(b)(3). In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before such date, and

(3) In the case of stock the basis shall be diminished by the amount of distributions previously made in respect of such stock, to the extent provided under the law applicable to the year in which the distribution was made.

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for stock of same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is

transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b)(4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(f) *Involuntary conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) *Same—effect on future distributions.*—The distribution, in pursuance of a plan of reorganization, by or on

behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of section 115(b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however affected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired upon an exchange described in section 112(b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

* * * * * * * *

(9) *Tax-free distributions.*—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112(g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

* * * * * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property.

* * * * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * * * *

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112(h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

(d) *Other distributions from capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this subsection shall also apply to distributions from depletion reserves based on the discovery value of mines.

* * * * * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

* * * * * * * *

EXHIBIT "B"

CERTAIN TREASURY RULINGS ON "REORGANIZATION" PROBLEMS PUBLISHED IN OR PRIOR TO 1921.

A. R. R.	693,	5 C. B.	207
O. D.	1071,	5 C. B.	62
O. D.	970,	5 C. B.	61
A. R. R.	665,	5 C. B.	59
O. D.	1058,	5 C. B.	58
O. D.	1051,	5 C. B.	58
O. D.	1080,	5 C. B.	56
O. D.	1008,	5 C. B.	56
O. D.	1064,	5 C. B.	53
S. O.	115,	5 C. B.	47
L. O.	1062,	4 C. B.	168
O. D.	938,	4 C. B.	46
O. D.	932,	4 C. B.	46
O. D.	783,	4 C. B.	45
O. D.	955,	4 C. B.	44
O. D.	912,	4 C. B.	30
S. O.	72,	3 C. B.	59
A. R. R.	173,	3 C. B.	58
A. R. M.	67,	3 C. B.	54
O. D.	693,	3 C. B.	40
L. O.	1023,	2 C. B.	310
S. O.	4,	2 C. B.	307
A. R. R.	126,	2 C. B.	44
S.	1294,	2 C. B.	41
O. D.	480,	2 C. B.	39
A. R. R.	156,	2 C. B.	39
O. D.	418,	2 C. B.	33
O. D.	479,	2 C. B.	29
A. R. R.	67,	2 C. B.	27
L. O.	942,	1 C. B.	300
O. D.	335,	1 C. B.	46
O. D.	204,	1 C. B.	46
T. B. R.	39,	1 C. B.	45
O. D.	308,	1 C. B.	43
O. D.	98,	1 C. B.	43
T. B. R.	25,	1 C. B.	39
A. R. R.	6,	1 C. B.	30

EXHIBIT "C"

THE REVENUE BILL OF 1921

(1) *Legislative history of the definition of "reorganization":*

As introduced in the House on August 15, 1921 (61 Cong. Rec. 5036), and as passed by the House, section 203 of the bill which became the Revenue Act of 1921 contained the following definition of "reorganization":

> "The word 'reorganization,' as used in this paragraph, includes a merger, consolidation (however effected), recapitalization, or a mere change in identity, form, or place of organization of a corporation;"

When the bill was reported to the Senate on September 21, 1921 (61 Cong. Rec. 5711), the definition read as follows:

> "The word 'reorganization,' as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of substantially all the stock or substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected);"

While the bill was being read in the Senate, Mr. McCumber, for the Committee on Finance, offered an amendment (61 Cong. Rec. 6549) the effect of which was to strike the following words from the definition:

> "merger or consolidation (including the acquisition by one corporation of substantially all the stock or substantially all the properties of another corporation)"

and insert in lieu thereof the following:

> "merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of

shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)''

After debate (61 Cong. Rec. 6549-6550, 6561-6569) this amendment was adopted (61 Cong. Rec. 6569) so that as passed by the Senate the definition read as follows:

''The word 'reorganization,' as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected);''

The Conference Committee accepted the amendment made on the floor of the Senate and the definition as so amended, and as last above set forth, was contained in the bill as finally approved by the President.

(2) *Extract from S. Rept. 275, 67th Cong., 1st. Sess., p. 11:*

EXCHANGES OF PROPERTY FOR PROPERTY.

* * * * * * * * * *

Under existing law ''when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any * * *.'' Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments. The existing law makes a presumption in favor of taxation. The proposed act modifies that presumption by providing that in the case of an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a readily

realizable market value, and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value. These classes comprise the cases where productive property (other than stock in trade or property held primarily for sale) used in a trade or business is exchanged for property of a like kind or use; where in any corporate reorganization or readjustment stock or securities are exchanged for stock or securities of a corporation which is a party to or results from such reorganization; and where an individual or individuals transfer property to a corporation and after such transfer are in control of such corporation.

The preceding amendments, if adopted, will, by removing a source of grave uncertainty and by eliminating many technical constructions which are economically unsound, not only permit business to go forward with the readjustments required by existing conditions but also will considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges.

Proper safeguards are found in subdivision (d), which provides that where property is exchanged for other property or where property is involuntarily converted into cash and the proceeds of such conversion are used to replace the property converted, or where a wash sale is not recognized, the property received in exchange shall be treated as taking the place of the original property.